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Twenty-eighth session

SUMMARY RECORD OF THE 553rd MEETING

Held at the Vienna International Centre, Vienna,
on Friday, 5 May 1995, at 9.30 a.m.

Chairman: Mr. GOH (Singapore)

Chairman of the Committee of the Whole: Mr. GAUTHIER (Canada)

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The meeting was called to order at 9.30 a.m.

DRAFT CONVENTION ON INDEPENDENT GUARANTEES AND STAND-BY LETTERS OF CREDIT (*continued*) (A/CN.9/405, A/CN.9/408, A/CN.9/411)

Article 11 (*continued*) (A/CN.9/408, annex)

1. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that it still remained to be decided whether to retain in paragraph (1) (c) of article 11 the words "unless the undertaking provides for the automatic renewal or for an automatic increase of the amount available or otherwise provides for continuation of the undertaking".

2. After inviting comments regarding the deletion of those words, he noted that the representative of Japan would prefer to delete them but that the majority of the members of the Commission wished to retain them.

3. *Paragraph (1) (c) was retained without change.*

4. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the other point to be decided was the scope of paragraph (2), which some had found difficult to understand.

5. **Mr. MARKUS** (Observer for Switzerland) saw a contradiction between paragraphs (1) and (2). Confusion or fraud by the beneficiary might be the result in cases where the guarantor, pursuant to article 1 (a), received a statement of release from liability from the beneficiary when the original instrument had stipulated that only the return of the instrument would lead to a cessation of the undertaking. That situation could be avoided by adding in the fourth line of paragraph (2) a full stop after "payment" and deleting the words "either alone or in conjunction with one of the events referred to in subparagraphs (a) and (b) of paragraph (1) of this article". The paragraph would then continue: "However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with paragraph (1) of this article preserve any rights of the beneficiary under the undertaking", the words "subparagraphs (c) or (d)" being deleted.

6. **Mr. GAUTHIER** (Chairman of the Committee of the Whole), referring to the first point made by the Swiss representative, said that there might be a need to make the link between paragraphs (1) and (2) clearer. Paragraph (2) spoke of the return of the instrument being the material consideration for cessation of the right to demand payment, while there was no such reference in paragraph (1).

7. The Swiss representative's second suggestion raised a substantive issue. In the current text, a distinction was made between the cases under paragraph (1) (a) and (b) and those under paragraph (1) (c) and (d). Under the Swiss proposal, all the situations under paragraph (1) (a) to (d) would be subject to the portion of the text reading "However, in no case shall retention of any such document by the beneficiary after the right to demand payment ceases in accordance with paragraph (1) of this article preserve any rights of the beneficiary under the undertaking".

8. **Ms. FENG Aimin** (China) said that she would prefer to retain the wording of paragraphs (1) and (2), but that if it was changed, the same rules would have to be included in articles 8, 9 and 10. Another solution might be to redraft article 7 (2).

9. **Ms. ASTOLA** (Finland) thought that the confusion arose from the first sentence of paragraph (2). She supported the Swiss proposal. Paragraph (1) (a) and (b) depended on the wish of the beneficiary, whereas paragraph (1) (c) and (d) did not. The explanation in the first sentence of paragraph (2) was unnecessary if the return of the document to the guarantor/issuer was required for the cessation of the right to demand payment. It could not be required if the event referred to in subparagraph (c) or (d) had occurred.

10. **Mr. LAMBERTZ** (Observer for Sweden) considered the issue to be more one of legal logic than of policy. He too found it a puzzling idea that if the original undertaking required the return of the document and if later the beneficiary released the bank from its liability in a separate statement, or, as provided for in paragraph (1) (b), there was a subsequent agreement on the termination of the undertaking, the provisions of the undertaking should still prevail and not be cancelled by the release.

11. He agreed with the observer for Switzerland that some amendments were needed and suggested the inclusion of a new paragraph (1) (e) stating that the right to demand payment terminated if the undertaking stated when the document had to be returned.

12. **Mr. RADWAN** (Observer for Arab Association for International Arbitration) suggested that paragraph (2) should be redrafted to say that the return of the document was presumed to have effected cessation and was proof thereof unless there was evidence to the contrary.

13. **Mr. CHOUKRI SBAI** (Observer for Morocco) considered that paragraph (2) was not mandatory, but explanatory. It was unnecessary to go into such detail, and the parties should be left to choose whatever option was in their best interests. The last sentence of the paragraph was superfluous, since there was no point in keeping a document after the relevant time period had expired. If payment had been made, proof to that effect would exist. He therefore proposed that paragraph (2) should be deleted.

14. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) explained that the Working Group had considered it important to stress in paragraph (2) that holding the document did not create the right to demand payment. In certain jurisdictions that was a point of contention, and it was therefore important to clarify the matter in the Convention.

15. **Ms. BAZAROVA** (Russian Federation) said that in her delegation's view the substance of paragraph (2) should be retained, although its drafting could possibly be improved. The proposed new paragraph (1) (e) did not make clear the voluntary nature of the return of the document embodying the undertaking, but appeared simply to describe an eventuality already provided for in paragraph (1) (a).

16. **Mr. SHISHIDO** (Japan), agreeing with the remarks made by the representative of the Russian Federation, said that his delegation preferred to keep the text of article 11 as it stood. Under the Swiss proposal, the parties no longer had the option of agreeing to make the return of the document part of the requirement for the cessation of the beneficiary's right to demand payment. Furthermore, a stipulation to the effect that the return of the document would by itself give rise to cessation presented difficulties. Such return merely constituted evidence, and it was difficult to regard it as an expression of the will of the beneficiary.

17. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) pointed out that the intention behind the proposed new paragraph (1) (e) was not to stipulate that the beneficiary's right to demand payment automatically ceased upon the return of the document embodying the undertaking, but rather to provide for a fifth event whereby that right would be terminated, subject to the parties' having so agreed in the undertaking. The beneficiary's right to demand payment would thus cease upon the first occurrence of one of the eventualities set out in subparagraphs (a) to (e). The Commission might perhaps wish to add a further paragraph, specifying that mere retention of the document following one of those occurrences did not have the effect of reinstating the undertaking.

18. **Mr. OGARRIO** (Mexico) suggested that the first part of paragraph (2) be redrafted to form the substance of a new paragraph (1) (e) and that the last part of paragraph (2) be retained and make reference to the first four subparagraphs of paragraph (1), but not to the new subparagraph (e), which would itself deal solely with cessation of the right to demand payment in the event of the return of the document, where such an agreement had been made between the parties.

19. **Mr. BOSSA** (Uganda) said that his delegation also supported the deletion of paragraph (2) and its partial replacement by a new paragraph (1) (e), which could perhaps be worded along the following lines: "If the document embodying the undertaking first stipulates that the document is returned to the guarantor/issuer. However, failure to return such document after the right to demand payment has ceased in accordance with subparagraphs (c) or (d) shall not preserve any rights of the beneficiary under the undertaking".

20. **Mr. ADENSAMER** (Austria) said that the proposed new paragraph (1) (e) did not satisfactorily deal with cases where, after it had been stipulated in the undertaking that the return of the document alone would give rise to termination of the right to demand payment, an adversarial situation arose, such as subsequent agreement by the guarantor/issuer and beneficiary regarding a different form of termination, as referred to in paragraph (1) (b). Which of those two arrangements would then apply? In his view, the more recent one should, since it constituted an amendment to the undertaking. He therefore supported the Swiss proposal.

21. **The CHAIRMAN**, speaking as representative of Singapore, said that, although he saw merit in the proposal to delete paragraph (2) and add a paragraph (1) (e), he shared the concern expressed by other delegations regarding the question of liability in cases where the document was retained. He therefore suggested that paragraph (2) should be kept but amended to read: "Where the right of the beneficiary to demand payment in accordance with paragraph (1) of this article has ceased, retention of the document by the beneficiary shall not preserve any right of the beneficiary under the undertaking".

22. **Mr. EDWARDS** (Australia) said that, while he could go along with the inclusion of the proposed paragraph (1) (e), that alone would not resolve the concern expressed by the representative of Austria. He thus suggested that a new paragraph (1) be drafted, stating that, if a stipulation was made in the undertaking to the effect that its termination could be effected only by the return of the document, then cessation would occur solely upon such return. Paragraph (2) would then provide for the other cases, i.e., where there was no such stipulation, and would state that termination would occur when one of the expiry events provided for in its subparagraphs (a), (b), (c), (d) and (e) arose, subparagraph (e) covering the eventuality of the simple return of the document. The new paragraph (3) would state that, if termination arose by reason of the occurrence of one of the events set out in paragraphs (2) (a), (b), (c) and (d), then retention of the document would not preserve any rights of the beneficiary.

23. **Mr. ILLESCAS** (Spain) said that the proposed amendments might affect the balance which the current wording of article 11 maintained with regard to guarantees. His own and many other countries applied the principle that guarantees were not negotiable instruments. The introduction of a new aspect at the end of the validity period of the undertaking might increase the weight of the documentary aspect of cessation to the detriment of its contractual aspect. It was not possible to regard the simple return of the document as constituting a discharge of liability, since that would give it the nature of a negotiable instrument. His delegation therefore preferred to retain the text of the article as it stood.

24. **Ms. CZERWENKA** (Germany), agreeing with the observations made by the representative of Finland, said that her delegation was in favour of retaining the substance of paragraph (2). If the parties stipulated that the return of the document was necessary for cessation of the beneficiary's right to demand payment, the will of the parties, as provided for in the proposed new paragraph (1) (e), would be overridden by the occurrence of the eventuality provided for in paragraph (1) (a), because the statement of release would be sufficient for cessation of the right to demand payment, regardless of the return of the document.

25. **Mr. SHIMIZU** (Japan) said that, if the undertaking stipulated that the return of the document alone would have the effect of terminating the undertaking, the parties could avail themselves of article 8 should they wish to amend that arrangement subsequently. A reference to that article might perhaps resolve the concern expressed by the representative of Austria.

26. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) suggested the following solution. Firstly, a new paragraph (1) (e) should be added, which would in essence state that where it was so stipulated in the undertaking, the right to demand payment ceased when the undertaking was returned to the guarantor/issuer. That would recognize the possibility for parties to stipulate that for the instrument to cease being available for payment, its return by the beneficiary to the guarantor/issuer was required. Secondly, language could be added to paragraph (2) to the effect that in no case should retention of the undertaking by the beneficiary after the right to demand payment ceased for any of the reasons set forth in subparagraphs (a), (b), (c) and (d) preserve any of the rights of the beneficiary under the undertaking.

The meeting was suspended at 10.50 a.m. and resumed at 11.20 a.m.

27. **Ms. ASTOLA** (Finland) asked whether, even under subparagraphs (c) and (d), retention of the undertaking was possible and the right to demand payment remained if it was stipulated that the undertaking must be returned.

28. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that the proposed subparagraph (e) represented a new situation, which must be clearly circumscribed, as it was not a mere provision requiring the return of the instrument in view of termination. If that situation occurred before any of the situations described in subparagraphs (a), (b), (c) and (d), that brought the right to demand payment to an end. But if any of those situations occurred first, then mere retention did not give the right to demand payment. As to paragraph (2), that would have to be understood as meaning that if the return of the instrument occurred before any one of the situations described in subparagraphs (a), (b), (c) and (d), then the right ceased. His proposal would also mean that it was no longer a question of the situations described in subparagraphs (a) and (b) being coupled with the question of return. Basically, it would mean that if one were given an instrument which said that the undertaking was terminated, then it was terminated. There would be five possibilities operating distinctly.

29. **Mr. CHOUKRI SBAI** (Observer for Morocco) said that the proposed addition of subparagraph (e) was a good change, but that the problem was not one of drafting. His delegation had been concerned by the fact that the document could be returned to the guarantor for a reason other than payment, such as correction of an error, in which case the beneficiary would retain it. However, it had been reassured by the explanation given by the Chairman of the Committee of the Whole that there would have to be an explicit reference to the fact that the document was being returned for payment. He asked whether the return of the document was definite proof of payment or whether the contrary could be proved by other means. If return was proof, wording could be added to the effect that the right to payment ceased unless the contrary was proved.

30. **Mr. MARKUS** (Observer for Switzerland) said that the proposal by the Chairman of the Committee of the Whole fully satisfied the concerns of his delegation and was an excellent way to resolve the problems.

31. **Mr. BYRNE** (United States of America) said the proposal did not meet the purpose of the first sentence of paragraph (2), which was to clarify that the second sentence did not mean that the prudent and sound practice of requiring the return of the instrument prior to its expiry signified an intent that the undertaking should be prematurely terminated. The idea of preventing the fraudulent re-use or circulation of the operative instrument was not included in the proposal by the Chairman of the Committee of the Whole. Instead, a new element was introduced in its place, which did either too much or too little. There was no need to address a situation in which the undertaking itself had a mechanism for termination by virtue of the return of the instrument, as that was covered by paragraph (1) (b). Any such provision would need to specify the reason for the return, as there were a number of situations in which a return might occur, but in a convention of the present sort to deal with a rather unusual situation which the parties had brought upon themselves was unnecessary and unwise.

32. **Mr. FARIDI ARAGHI** (Islamic Republic of Iran) said that the proposal by the Chairman of the Committee of the Whole would make things more complicated and left the question of payment open. He was satisfied with the present text, which would avoid any misunderstanding.

33. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) suggested that the idea of a subparagraph (e) should be dropped, that paragraph (1) should be left unchanged and that in the second sentence of paragraph (2) the words "subparagraphs (c) or (d) of" should be deleted.

34. **Mr. ILLESCAS** (Spain) said that while that change might be acceptable, it should be accompanied by the deletion in the first sentence of paragraph (2) of the words "either alone or" in order to clarify the situation. Those words did not fit with the imperative nature of paragraph (1), which seemed to establish means of cessation without allowing for other possibilities. None the less, the words "either alone or" created a fifth possibility consisting simply of the return, with which he disagreed. Paragraph (1) would then have a considerable bearing on paragraph (2), which would be an appendix to subparagraphs (a) and (b) of paragraph (1), but would not add any element to the issue of the right to demand payment.

35. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he took it that the Commission wished to retain article 11 as drafted.

36. *It was so decided.*

Article 19 (A/CN.9/408, annex)

37. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that article 19 was the only provision on which no consensus had been achievable in the Working Group. It was a key provision, because the whole area of bank guarantees, stand-by letters of credit and commercial letters of credit, which were otherwise extremely successful instruments, was plagued by the question of fraud and its effects.

38. **Mr. VASSEUR** (Observer for Monaco) said that articles 19 and 20 were the pillars of the Convention. Speaking on behalf of the Ministry of Foreign Affairs of Monaco and the Association of Monaco Banks and in the light of letters addressed to the Secretary in May 1993 and September 1994 by the Banking Federation of the European Union, he said that the Banking Federation was deeply disappointed that the draft Convention did not contain explicit provisions on counter-guarantees. It was especially disappointed that article 19 appeared to completely disregard the problem of fraudulent or otherwise improper demands, and in particular the counter-guarantee regime in such cases. The Banking Federation wanted a clear rule that a fraudulent or otherwise improper demand on the first guarantor did not render the counter-guarantee regime itself fraudulent. As a corollary, the counter-guarantee should only be regarded as abusive in the event of complicity between the beneficiary making its demand on unfounded, abusive or fraudulent grounds and the first banker calling on the counter-guarantee. The disappointment of the Banking Federation over the issue was particularly acute in that an earlier draft of article 19 had contained a provision regarding the counter-guarantee. That text had been examined at the seventeenth session of the Working Group in April 1992, and the Working Group had at the time expressly agreed that the issue of counter-guarantees should be covered by article 19. A working paper produced in Vienna in 1992 had also dealt with the subject. Nor had the Working Group, at the twentieth session in November 1993, called explicitly for the deletion of all provisions regarding the counter-guarantee. The Banking Federation urged the Commission to ensure that article 19 covered the counter-guarantee in the event of a fraudulent or otherwise improper demand.

39. The Banking Federation also reserved its position in regard to the wording of article 19 (1) (a) (iii), which defined a fraudulent demand as one that had "no conceivable basis". The wording implied that the guarantor/issuer was expected to ask itself whether the demand had a "conceivable basis", a form of words that was not compatible with a guarantee given "on simple demand". If the demand was consistent with the letter of guarantee, it was up to the banker to pay; it was not his job to ask questions. The present wording might compel the banker to undertake verifications, to check that none of the situations mentioned in paragraph (2) applied, before making the payment. It could put an end to guarantees based on simple demand, which were in fact the most common type of guarantee used throughout the world and which the Working Group itself felt should continue in use and be covered by the Convention. Furthermore, the wording used, with its reference to "no conceivable basis", seriously impaired the independence of the guarantee as enshrined in article 3 of the draft Convention. In consequence, the Banking Federation suggested that the first line of article 19 (1) (a) should read "if, in the view of the guarantor/issuer, it is manifest, clear and beyond any doubt that" and that paragraph (1) (a) (iii) should be deleted. It also took the view that paragraph (2) was not absolutely necessary, but that if, it was to be retained, the second part of the first line should read "the following are types of situations in which, beyond any doubt, no payment is due". The point was that it should be clear, manifest and beyond any doubt that the call for payment was fraudulent or otherwise improper.

(*Mr. Vasseur, Observer for Monaco*)

40. He was also dissatisfied with the title of article 19, which had been proposed fairly recently, after the previous title had been justifiably discarded. It should not lay the stress on the behaviour of the banker. In several countries, including France, Germany and Switzerland, recent case law had shown that if the banker wished to make a payment in such circumstances, he could do so, but that he could not request repayment on the part of the principal. It was the banker who gave his guarantee, and if, for his own reasons, such as the desire not to undermine his international credibility, he decided to pay, he should be free to do so. There existed blacklists of banks reputed to be poor payers, and the major European banks had no desire to be placed on such lists. A number of court decisions had been made along those lines in several countries. The words "good faith" in the last line of paragraph (1) (a) were also unsatisfactory, since the real point was whether the banker could reclaim repayment from the principal. In regard to the title, the original reference to abuse and fraud had, it seemed, disconcerted certain countries, especially those with common-law systems, which did not recognize the concept of abuse. The difficulty could be avoided by amending the title to "fraudulent demands and similar situations", in which the term "similar situations" would cover the question of abuse. There were also cases of *force majeure* in which the principal was prevented from executing his obligations; one such case was that of embargoes, which the Convention should not simply ignore.

41. He concluded by stating that the content of articles 19 and 20 as finally decided would determine the future attitude of the banks towards the Convention. Although it was not the role of UNCITRAL to please the banks or of the banks to please UNCITRAL, it had to be remembered that it was essentially the banks that gave guarantees, that article 1 of the Convention made provision for the possibility of exclusion, that it was usually the beneficiary that proposed the text of the guarantee and that it also had the possibility of imposing the exclusion of the application of the guarantee. Beneficiaries would not favour the Convention if it appeared to impair in any way the rigour of the guarantee. Correspondents of major European banks in the principal countries benefiting from guarantees had expressed very strong reservations in regard to articles 19 and 20, and the representative of the United States of America had warned against any provision that might impair the integrity of the argument. All those issues should be carefully considered in drafting such key articles of the Convention.

42. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said that one of the difficulties throughout the process of drafting the text had been the diversity of definitions of fraud and abuse. That was why, after long discussion, a descriptive approach had been adopted in paragraph (1) (a). It would, in his view, be dangerous to return to concepts that were natural to some people because of their training but not to others. The aim must be to achieve consensus.

43. **Mr. SHISHIDO** (Japan) asked whether article 19 was mandatory or not and whether a party could agree to give the bank absolute freedom to pay or not to pay. If the article was not mandatory, it would not need to be discussed so seriously, but if it was, it would have to be worded very carefully. The whole structure of the article was based on the principle that when a demand was manifestly and clearly improper, no payment would be made, and the beneficiary could not seek damages against the guarantor/issuer and had no right to reimbursement. Problems would arise because of two exceptional cases that might occur involving misjudgement. In the first, the guarantor/issuer made a payment when he should not have done so. That payment would not be in good faith and the banker would not be able to obtain reimbursement from the principal. In that case, there was a difficulty with the wording of paragraph (1) (a), in which the phrase "in the view of the guarantor/issuer" was ambiguous and misleading. Despite the reasons given for that wording

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(*Mr. Shishido, Japan*)

in paragraph 70 of document A/CN.9/408, the terminology used suggested that the payment depended absolutely on the judgement of the guarantor/issuer, which was not the intention. He therefore proposed that the phrase "in the view of the guarantor/issuer" be deleted.

44. **Mr. GAUTHIER** (Chairman of the Committee of the Whole) said he would invite the representative of Japan to conclude his statement at the next meeting.

The meeting rose at 12.35 p.m.